



# 1 MACROECONOMIC DEVELOPMENTS

## 1.1 THE EXTERNAL ECONOMIC ENVIRONMENT

### 1.1.1 GLOBAL TRENDS IN OUTPUT AND PRICES

Global economic growth slowed to around 3.0% in 2016, which was down from 3.2% in the previous year and its lowest rate since 2009. Global growth therefore remained below the average rate of 4% recorded over the two decades before the Great Recession. The trends of accelerating GDP growth across advanced economies and decelerating growth across emerging market economies (EMEs) both came to an end in the period under review. While activity growth in the advanced world slowed significantly in 2016, EME growth rates were comparable to those in 2015.

The course of the world economy in 2016 was affected by several factors. These included China's structural slowdown and the gradual rebalancing of the Chinese economy. Thanks to an accommodative monetary policy stance, exchange rate depreciation and investment in state-owned firms, China stabilised its economic performance and achieved its target growth rate. Nevertheless, such steps to support activity indicate that China needs to do more in the adoption of structural reforms that would in future help make the economy more balanced. India's economy grew more moderately in 2016, but nevertheless benefited from buoyant confidence, progress in economic reforms, and robust investment. Furthermore, public sector wage growth and structural reforms in the area of goods and services taxation are expected to sustain activity growth at high levels via business investment. Commodity price developments also had an impact on the world economy in 2016. Most notable was the impact of rebounding oil prices on oil exporting economies. Although the Russian economy continued to contract, its recession was more moderate compared with the previous year, and the upward trend in oil prices bodes well for the economy going forward. In addition, falling inflation reduced the rate of decline in consumption. Monetary policy provided further support to the economy, as rates were lowered in response to the disinflationary trend. In Brazil, a combination

of political uncertainty, tight monetary policy and financial conditions, and planned fiscal consolidation measures weighed on the economy. The economy, still weakened by high unemployment, low levels of business and consumer confidence, and the effects of subdued commodity prices, again contracted. The world economy was also adversely affected by persisting geopolitical tensions in certain parts of the world.

Advanced economies contributed to the slowdown of the world economy in 2016, with growth rates sliding in almost all the major economies. In the United States, economic growth was dampened by the negative impact of energy sector investments as well as by the effects of past appreciation of the US dollar. At the same time, the savings households made during the period of low energy prices did not have a significant upward impact on household consumption. US economic growth was nevertheless starting to be supported towards the year-end by higher household spending and a pick-up in investment demand. The United Kingdom's economy grew more slowly in 2016 than in 2015 since, despite an acceleration in private consumption, investment and net trade dampened the growth rate. Although the financial market volatility that followed the UK's June referendum vote to leave the European Union was short-lived, the uncertainty surrounding the future setting of the country's relations with the EU heightened the downside risk to the global growth outlook. Euro area economic growth also slowed moderately in 2016. The Japanese economy, its growth increased by fiscal stimuli and an accommodative monetary policy stance, had a positive impact on global GDP growth. Another factor that affected the global economy was the divergence between monetary policy in the United States and other advanced countries. In December the Federal Reserve System's Federal Open Market Committee decided to raise the target range for the federal funds rate, in contrast to accommodative monetary policies still being followed by other central banks.

Global headline inflation accelerated in 2016, mainly because the rate of decline in energy prices moderated in response to energy com-



modity price movements. Food prices increased only marginally and their inflation rate was notably lower compared with the previous year. The average inflation rate across advanced economies increased to 0.7% in 2016, from 0.3% in 2015, although core inflation remained muted in an environment of weaker economic growth. Among EMEs, the average headline inflation rate slowed from 4.7% to 4.5% owing to the fading impact of past currency depreciations and to the impact of monetary policies.

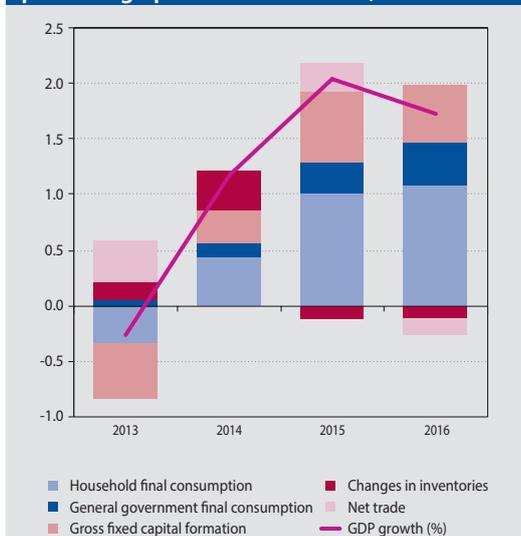
World commodity prices rebounded in 2016. Although global commodity price inflation remained negative for 2016 as a whole, its year-on-year rate during the course of the year became moderately less negative and eventually turned positive. Energy commodity prices had the main impact on the overall rate, due mainly to an increase in oil prices. The average oil price came under upward pressure on the supply side when OPEC and non-OPEC oil producers agreed to cut oil output. On the demand side, the oil price was affected by lower economic growth in China. Coal prices also climbed in 2016 in response to the China's industrial restructuring. As for non-energy commodities, prices of metals and agricultural commodities increased gradually due to falling supply and higher demand, as well as to the rise in oil prices.

### 1.1.2 THE EURO AREA

The euro area economy continued to grow in 2016, although its year-on-year expansion of 1.7% was slightly lower compared with 2015. That year's growth rate had been revised up to 2% on the basis of strong growth in Ireland. The largest contribution to last year's growth was made by private consumption, with smaller contributions from investment and government consumption. Private consumption and investment were buoyed significantly by the accommodative monetary policy stance and consequent easing of lending conditions. Export growth was lower in 2016 than in 2015, as was import growth, albeit to a lesser extent. Hence, net trade made a negative contribution to the euro area's annual GDP growth. The strengthening economy had a positive impact on the labour market, with the unemployment rate averaging 10.0 % in 2016, down from 10.9% in 2015.

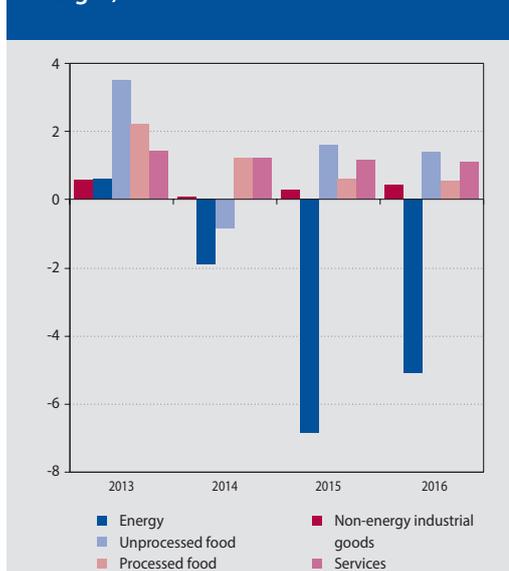
Average annual inflation as measured by the Harmonised Index of Consumer Prices (HICP) increased in 2016 by 0.2 percentage point, year on year, to 0.2%. The headline HICP inflation rate for December 2016 was 1.1%, up from a rate of 0.2% for the previous December. Inflation was in negative territory in the first three months of 2016 and increased only gradually over the second half of the year. Energy commodity price

**Chart 1 Euro area GDP and its composition (quarter-on-quarter percentage changes; percentage point contributions)**



Source: Eurostat.

**Chart 2 HICP components (annual percentage changes)**



Source: Eurostat.



movements had the greatest impact on HICP inflation during the year. They caused the annual rate of change in the energy component to become more negative, before this declining trend began to fade in the second half of the year. Food inflation accelerated towards the end of the year, while core inflation (HICP inflation excluding energy and unprocessed food) remained steady from April after previously increasing slightly. The average core inflation rate was the same in 2016 as in the previous year, at 0.8%.

The euro's exchange rate against the US dollar was weaker at the end of 2016 than at the start of the year, by around 3%. Its initial strengthening tendency gave way, from June, to a broadly stable phase and then, in the last quarter, to notable depreciation. This pattern reflected different cyclical positions and monetary policy stances in major world economies, geopolitical developments, and outlooks for economic growth and inflation in the euro area.

## 1.2 MACROECONOMIC DEVELOPMENTS IN SLOVAKIA

Slovakia's GDP at constant prices increased in 2016 by 3.3%, year on year, after increasing by 3.8% in 2015. The slowdown reflected a drop in domestic demand, particularly in investment. On the other hand, household consumption and net trade contributed positively to GDP growth, even more so than they did in 2015.

The labour market situation remained favourable in 2016. Employment as defined in the ESA 2010 grew in 2016 by 2.4%, year on year, due largely to job growth in the sectors of services and business activities. The average unemployment rate fell from 11.5% in 2015 to 9.7% in 2016. The average monthly nominal wage increased in 2016, as did its year-on-year rate of change. Wages grew in all sectors apart from information and telecommunication technologies.

In the balance of payments, the current account showed a deficit €0.6 billion (after a surplus of €0.2 billion in 2015). The deficit was caused largely by a widening of the deficit in the primary income balance, as well as by a drop in the absorption of EU funds.

The average annual inflation rate was more negative in 2016, at -0.5%, than in 2015 (-0.3%). Headline inflation was strongly affected by the impact of external factors in the form of commodity price shocks.

### 1.2.1 PRICE DEVELOPMENTS

The average annual HICP inflation rate edged further into negative territory in 2016 to stand at -0.5% (the rate for 2015 was -0.3%). This difference between the average year-on-year rates for 2016 and 2015 was caused mainly by external factors (food prices) and to a lesser extent by a slight slowdown in non-energy industrial goods inflation.

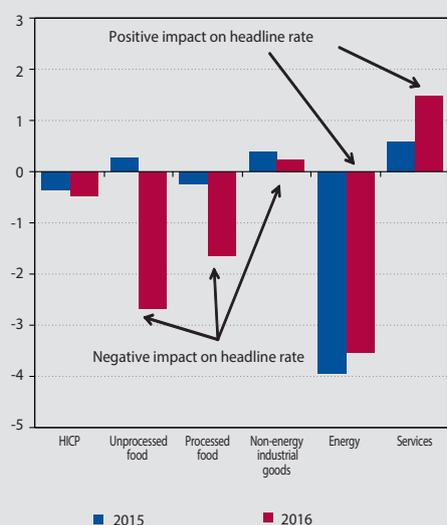
In the first half of 2016 processed food prices were falling, particularly due to falling agricultural commodity prices. Another factor that weighed on headline HICP inflation, through the food component, was the January 2016 reduction in VAT on selected food products.

Oil prices remained very low in 2016 despite rebounding somewhat near the year-end. The average price of automotive fuel fell by almost 7% in 2016. Falling oil prices were one of the causes of the persisting low inflation environment not only in Slovakia, but also in other euro area countries. Low wholesale gas prices in Europe in 2015 and 2016 resulted in reductions in Slovak consumer gas prices in January and July 2016. Electricity prices were also cut at the beginning of the year in response to falling energy commodity prices. Energy prices in 2016 therefore fell by an average of 3.5%, year on year.

Weak imported inflation helped ensure a low rate of non-energy industrial goods inflation (0.2%). Prices of these goods may also have reflected the impact of structural changes in the Slovak retail trade market (technological advances in global production processes and logistics, rapid development of new sales channels).

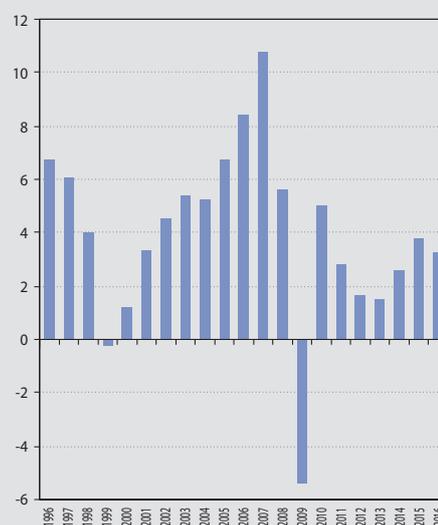
The average rate of annual services inflation was slightly higher in 2016 than in 2015, at 1.5%. This increase reflected the fading impact of train fare reductions and increases in prices of restaurant, personal care, and financial services. Despite favourable trends in the labour market and in household final consumption, services inflation excluding administered prices

**Chart 3 The HICP and its components (annual percentage changes)**



Sources: SO SR and NBS calculations.

**Chart 5 Real GDP (annual percentage changes)**



Source: SO SR.

**Chart 4 Contributions of components to the difference between the average HICP inflation rates for 2016 and 2015 (percentage point contributions)**



Sources: SO SR and NBS calculations.

was notably subdued throughout the year owing to the pass-through of declines in food and energy prices.

### 1.2.2 GROSS DOMESTIC PRODUCT

Slovakia's GDP at constant prices increased in 2016 by 3.3%, year on year, after increasing by

3.8% in 2015. The slowdown stemmed mainly from a drop in domestic demand, particularly in investment. Nominal GDP for the year amounted to €81 billion, which was 2.9% higher compared with 2015. The nominal growth was lower than the real growth owing to a decline in the general price level, as measured by the GDP deflator. The GDP deflator fell by 0.4% year-on-year (after falling by 0.2% in both 2015 and 2014) owing to the downward paths of consumer, producer, import and export prices.

#### GDP – THE EXPENDITURE SIDE

Domestic demand fell by 0.4% in 2016, after growing by 6.1% in the previous year. The decline was attributable to lower investment, which reflected an appreciable drop in the absorption of EU funds. Public investment declined more than other areas of investment (by 44%), owing mainly to a drop in investment in other structures. By contrast, household consumption continued to grow and at an even faster pace compared with 2015. Net trade contributed positively to annual GDP growth, as growth in exports of goods and services (4.8% year-on-year) outperformed import growth (2.9%). In the previous two years net trade had made a negative contribution.

Looking at the components of domestic demand, household consumption showed relatively strong growth, which was caused by an

**Table 1 GDP on the expenditure approach (index: same period a year earlier = 100; constant prices)**

	2015	2016				
	Q1-Q4	Q1	Q2	Q3	Q4	Q1-Q4
Gross domestic product	103.8	103.4	103.8	103.0	103.0	103.3
Final consumption of households and non-profit institutions serving households	102.2	102.6	103.1	102.5	103.2	102.9
Final consumption of general government	105.4	103.6	102.5	102.1	99.0	101.6
Gross fixed capital formation	116.9	101.8	98.9	83.0	85.0	90.7
Exports of goods and services	107.0	100.3	107.8	104.5	106.3	104.8
Imports of goods and services	108.1	100.3	105.9	100.8	104.5	102.9

Source: SO SR.

acceleration in household disposable income. That income growth stemmed from the ongoing improvement in the labour market situation and the decline in inflation. Thus households were able to increase their spending on other, non-essential goods and services (such as recreation, culture, home furnishings). Government consumption grew more slowly than private consumption, and its growth of 1.6% was largely attributable to compensation of employees.

Export performance was responsive to demand trends in Slovakia's trading partners, with export growth accelerating gradually over 2016 and its average annual growth rate for the year standing at 4.8%. In sectoral terms, export growth was strongest in the car industry, while in terms of geographical destinations, exports to EU markets increased the most.

Export performance as measured by the exports-to-GDP ratio increased, year on year, by 0.3 percentage point to around 94%. At the same time, import intensity fell by 1.1 percentage point. As for the openness of the Slovak economy, measured by goods and services exports and imports as a percentage of GDP, it fell by 0.7 percentage point, to 183.9%.

### 1.2.3 THE LABOUR MARKET

The long-running improving trend in the labour market continued in 2016, as a corollary of economic growth. Average nominal wage growth was attributable to the still rising demand for labour and increasing labour force shortages. The unemployment rate fell steadily, and by the year-end it was down to single digits and close to its historical low.

### EMPLOYMENT

Employment as defined in the ESA 2010 grew in 2016 by 2.4%, year on year, after increasing by 2.0% in 2015. The number of hours worked also rose, by 1.6% (1.7 % in 2015). The sectors accounting for most of the employment growth were services and business activities. The job growth in construction was also worth noting, given that the sector had contributed negatively to the overall rate since 2010. Public sector employment<sup>1</sup> grew by 1.8% (after increasing by 1.3% in 2015), based mainly on job growth in the health care and, to a lesser extent, administration sectors. According to the Labour Force Survey, the number of Slovak citizens working abroad in 2016 rose by 7.9% (11,700 people) on a year-on-year basis, after increasing by 10.5% (14,000 people) in 2015.

### UNEMPLOYMENT

The number of unemployed as measured by the Labour Force Survey fell, year on year, by 15.4% (more than 48,000) and the unemployment rate decreased by 1.8 percentage point, to 9.7%. The average registered unemployment rate, based on labour office data, fell by two percentage points in 2016, to 9.5%. The difference between the increase in employment and decrease in unemployment in terms of number of people was 68,000 (according to the Labour Force Survey, which includes Slovak citizens employed abroad and people on labour activation schemes, but does not fully cover the increase of around 8,000 in the number of foreigners working in Slovakia). That employment growth exceeded the decline in unemployment was due not only to the increased employment of foreign nationals, but also to a rising labour force participation

<sup>1</sup> Including also the health and education sectors.

**Table 2 Labour market indicators**

	2015	2016				
	Q1-Q4	Q1	Q2	Q3	Q4	Q1-Q4
Nominal wages (index)	102.9	103.3	102.7	103.3	103.6	103.3
Real wages (index)	103.2	103.8	103.4	104.0	103.7	103.8
Nominal compensation per employee – ESA 2010 (index)	103.1	102.2	101.4	100.8	102.5	101.8
Labour productivity – GDP per employee (index; current prices)	101.6	100.7	101.1	99.9	100.3	100.5
Labour productivity – GDP per employee (index; constant prices)	101.8	101.1	101.5	100.5	100.4	100.9
Employment – ESA 2010 (index)	102.0	102.2	102.3	102.4	102.6	102.4
Unemployment rate – LFS <sup>1)</sup> (%)	11.5	10.4	9.6	9.5	9.1	9.7
Nominal unit labour costs (ULCs) <sup>2)</sup>	101.3	101.0	99.9	100.3	102.1	100.9

Sources: SO SR and NBS calculations.

1) Labour Force Survey.

2) Ratio of compensation per employee growth at current prices to labour productivity growth (ESA 2010) at constant prices.

rate. The number of people entering the labour market (employment) after being economically inactive was higher than the number leaving the labour force (for example, to retire). The labour force participation rate for the age group 15-64 increased by one percentage point in 2016, to 71.9%.

#### WAGES AND LABOUR PRODUCTIVITY

The average monthly nominal wage in 2016 increased to €912, and its annual growth rate accelerated to 3.3% (from 2.9% in 2015). Wage growth was strengthened by the labour market situation, as labour shortages started being perceived in several sectors and led to wage competition among employers. All sectors reported nominal wage growth in 2016 with the exception of information and telecommunication technologies (-0.7%). Wage growth was highest in agriculture (7.2%), and also robust in mining and quarrying (6.9%), public administration (6.6%), human health services (5.8%), and electricity, gas and steam supply (6.2%). Among the principal sector groupings, industry and services experienced a moderate increase in wage growth. As for the rate of change in real wages, the situation was the same as in 2015, as a year-on-year drop in the overall price level resulted in real wage growth exceeding nominal wage growth. Labour productivity (GDP per employee) increased moderately in 2016, while nominal labour productivity growth continued to trail nominal wage growth.

Such a situation could support price growth in the near term, but if it persisted for a longer time and spread to export-oriented industries, could weigh on the economy's competitiveness.

#### 1.2.4 FINANCIAL RESULTS

The aggregate profit of non-financial and financial corporations in Slovakia increased in 2016 by 7.3%, year on year, to €12,486.53 million (after increasing by 13.6% in 2015), according to the SO SR's preliminary data. Financial corporations contributed positively to the growth as their overall profit increased by 56.3%. Companies classified as other financial intermediaries reported the strongest profit growth, while banks excluding NBS increased their total profit by 15.3% (their profit in 2015 grew by 13.5%). The aggregate profit of non-financial corporations (NFCs) increased by 1.1% (after soaring by 21.6% in 2015).

In absolute terms, the profit of the NFC sector increased by €117.4 million, year on year, to €10,442.9 million. The sectors that accounted for most of the NFC sector's profit growth were real estate activities on a fee or contract basis, and the manufacture of basic metals and fabricated metal products. By contrast, profits fell in agriculture and in the supply of water, electricity, gas and steam.

Also as a result of certain extraordinary effects, the total profit of the financial sector (excluding



NBS) increased in 2016 by €577.5 million, year on year, to €1,878.55 million.

### 1.2.5 BALANCE OF PAYMENTS

#### CURRENT ACCOUNT

In Slovakia's balance of payments for 2016, the current account showed a deficit of €0.6 billion, after a modest surplus in 2015. This deterioration was caused largely by a widening of the deficit in the primary income balance, which reflected a drop in the absorption of EU funds. The ratio of the current account balance to GDP (at current prices) therefore worsened by 0.9 percentage point, to stand at a deficit of 0.7%.

As in the previous year, the car industry had a positive impact on overall export growth. Other sectors that notably supported export growth were metal processing and the supply of gas and electricity. Import growth slowed more, year on year, than export growth, owing to the fading of the impact of higher investment imports that had been supported by the absorption of EU funds. Hence, export growth (3.3%) was higher than import growth (3.0%), resulting in a year-on-year improvement in the trade balance.

The services balance surplus was higher in 2016 than in 2015. The improvement was based on

**Table 3 The current account and capital account balances (EUR billions)**

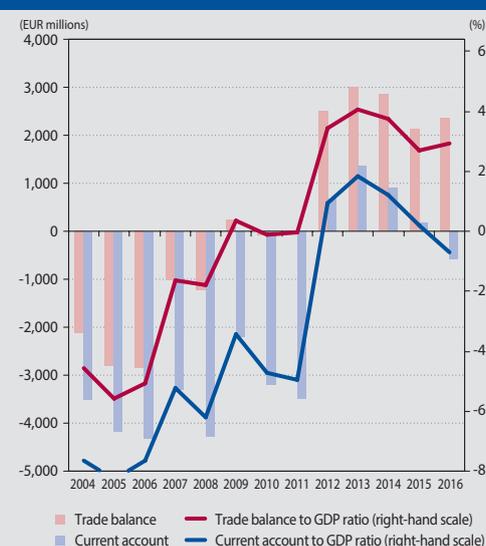
	2015	2016
Goods	2.1	2.4
Exports	66.1	68.3
Imports	64.0	65.9
Services	0.1	0.3
Primary income balance	-0.9	-2.1
Secondary income balance	-1.1	-1.2
<b>Current account</b>	<b>0.2</b>	<b>-0.6</b>
Current account to GDP ratio (%)	0.2	-0.7
<b>Capital account</b>	<b>2.8</b>	<b>1.6</b>

Sources: SO SR and NBS.

an increase in the *travel and transportation* item, which reflected growth in the number of foreign tourists visiting Slovakia (partly related to concerns about the safety of other destinations). As a result of the lower absorption of EU funds, the deficit in the primary income balance increased.

The capital account in 2016 followed a similar course to the current account. The capital account surplus contracted sharply, year on year, owing mainly to the fact that several major infrastructure projects reached completion at the end of 2015.

**Chart 6 Current account balance and trade balance**



Sources: SO SR and NBS calculations.

#### FINANCIAL ACCOUNT

The balance of payments financial account recorded a net inflow of €0.2 billion in 2016, which compared with 2015 represented an increase of €1.0 billion.

**Table 4 The financial account balance (EUR billions)**

	2015	2016
Direct investment	0.0	0.2
Portfolio investment and financial derivatives	2.1	3.5
Other investment	-1.5	-3.9
Reserve assets	0.2	0.0
<b>Financial account</b>	<b>0.8</b>	<b>-0.2</b>

Sources: NBS.

Note: The figures for the financial account balances are shown in net terms (assets minus liabilities), with a positive value denoting a net outflow and a negative value denoting a net inflow.

In the direct investment balance of the financial account, the net outflow was caused by the outflow of debt capital arising from the activity of economic agents (i.e. the amount of loans provided exceeded the amount of loans received). This outflow exceeded the inflow of funds in the form of non-residents' investments in equity participations. The outflow in the portfolio investment balance was largely attributable to the implementation of NBS's investment policies. The inflow in the other investment balance reflected mainly an increase in the amount of funds deposited with NBS.

#### EXTERNAL DEBT OF SLOVAKIA

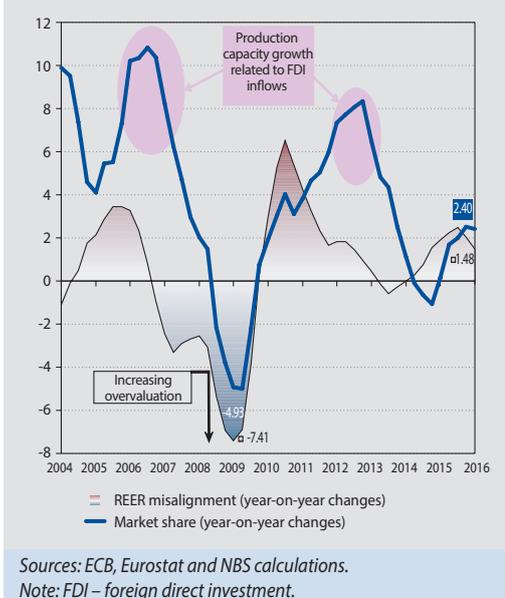
The balance of payments transactions in 2016 resulted in Slovakia's external debt increasing to €73.8 billion as at 31 December 2016, up from €67.2 billion as at the end of 2015. According to preliminary figures, the ratio of Slovakia's total gross external debt to GDP at current prices was 93.1% as at 31 December 2016, which was 7.0 percentage point higher compared with the end of 2015 (86.1%). The ratio of total short-term external debt to total gross external debt as at the end of December 2016 was higher, year-on-year, by 6.6 percentage points, at 38.8%. Debt per capita amounted to €13,605 as at the end of 2016, an increase of €1,207 on its level a year earlier.

#### NOMINAL AND REAL EFFECTIVE EXCHANGE RATES<sup>2</sup>

The nominal effective exchange rate (NEER) appreciated in 2016 by an average of 1.5%, year on year, after depreciating by 1.9% in the previous year. Appreciation vis-à-vis the pound sterling – following the UK's vote to leave the EU – made the largest contribution (0.6 percentage point) to the NEER's increase. Appreciation against the Chinese yuan and Polish zloty also had a positive impact (0.4 percentage point in each case). The main downward pressure on the NEER came from depreciation vis-à-vis the Czech koruna, with a negative contribution of 0.1 percentage point.

The year-on-year depreciation of the real effective exchange rate (REER) based on the producer price index-manufacturing averaged 0.6% in

**Chart 7 Year-on-year changes in the misalignment of REER based on PPI-manufacturing and in market share (centred five-quarter moving average; percentage points; percentages)**



2016, which compared with its depreciation in 2015 was more moderate by 1.8 percentage points. The REER's weakening resulted from the negative inflation differential against Slovakia's most important trading partners. The largest negative inflation differentials were with Russia (-8.5 percentage points), Poland (-3.8 percentage points), the United Kingdom (-3.5 percentage points) and Germany (-2.7 percentage points). After taking into account trading partners' weights in the REER, the negative inflation differentials that contributed the most to the REER's depreciation were those with Germany (-0.8 percentage point) and Poland (-0.3 percentage point). Since the REER's estimated equilibrium path continues to appreciate – due largely to equilibrium labour productivity growth being higher in Slovakia than in the trading partners – the REER's depreciation increased its undervaluation. A more undervalued REER continued to support the price competitiveness of domestic firms, which may have contributed to the pickup in the share of Slovak exports in world trade.

<sup>2</sup> The methodology used to calculate the effective exchange rate is published on the NBS website at [http://www.nbs.sk/\\_img/Documents/\\_Statistika/VybrMakroUkaz/EER/NEER\\_REER\\_Methodology.pdf](http://www.nbs.sk/_img/Documents/_Statistika/VybrMakroUkaz/EER/NEER_REER_Methodology.pdf)